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ABSTRACT

This issue of Capital Ideas reproduces, in an abridged form, the first chapter of a new book titled, "Financial Planning Under Economic Uncertainty", in the series, "New Directions for Higher Education." The chapter reviews the macroeconomic environment at the start of the 1990s, with particular focus on the problems facing policymakers. Sections examine: the economic environment in brief; the most likely scenario (generally favorable conditions with moderate growth and inflation) and its effects on higher education; alternative scenarios (both recession and inflation) and possible triggers of each. Implications for colleges and universities of these scenarios are discussed and strategies are recommended under the following categories: (1) current operations; (2) capital for facilities and equipment; (3) investments; and (4) public image. Overall, since the macroeconomic environment is likely to be extremely volatile for the coming decade, colleges and universities are encouraged to conserve capital for use on facilities and equipment and to provide investment return for future operating subsidies. They are discouraged from dissipating capital through current operating deficits however strong immediate program claims might be. They are also discouraged from investments which do not take into account the possibility of a sharp recession or sustained inflation. Nine references. (DB)

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THE ECONOMIC OUTLOOK AND WHAT IT MEANS FOR COLLEGES AND UNIVERSITIES

Richard E. Anderson and William F. Massy

A little over a year ago the Forum published an issue of *Capital Ideas* on the economy and higher education. Since then we held our second symposium on this topic at Annapolis, Maryland. The papers from that November 1988 meeting will be published shortly by Jossey-Bass in a "New Directions for Higher Education" volume entitled *Financial Planning Under Economic Uncertainty*. Authors and topics in the volume include:

1) *William Nordhaus,* John Musser Professor of Economics at Yale University offers a model that institutions can adopt to assess their vulnerability to macro-economic shocks;
2) *Aaron Gurwitz,* Senior Economist at Goldman Sachs & Co. discusses financial hedging techniques that can be used by colleges and universities;
3) *Timothy Dalton,* President of Dillon Read Capital Inc. and *Kenneth Greiner,* Senior Vice President at Dillon, Read, & Co. outline a method for endowment investing in the 1990s;
4) *Troy Murray,* a Managing Director of Cambridge Associates provides a brief review of macro-economic extremes;
5) *Stephen Gold,* Director of Fiscal Studies at the National Conference of State Legislators reviews prospects for state financing of higher education;
6) *Richard Anderson & Joel Meyerson,* Co-directors of the Forum, summarize the volume and consider constraints and prospects for federal financing of higher education.

The first chapter of the volume, by Richard Anderson and William Massy is reproduced in an abridged form in this edition of *Capital Ideas*. The Piece reviews the macro-economic environment as we enter the 1990s. It specifically focuses on the problems facing policy makers and offers speccific advice for the financial management of colleges and universities.

Attention to economic **problems** may seem misplaced at a time when the stock and bond markets are strong, when unemployment is low, and, the Phillips curve notwithstanding, inflation is in check. But serious imbalances persist in our economy which must be addressed. As Tim Dalton and Ken Greiner of Dillon have argued, these imbalances are likely to be wrung out by discipline imposed on our economy by the financial markets. College administrators in the 1990's will be able to better serve their institutions if they have some understanding of these macro-economic issues and the associated institutional risks.

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THE ECONOMIC ENVIRONMENT IN BRIEF

The current macroeconomic environment is dominated by major imbalances in consumption, savings, and investment. Specifically, in the 1980s the United States saved too little— consuming far more than justified by growth in national productivity.

While it is generally acknowledged that colleges and universities have a significant impact on the national economy, the causal forces between higher education and the economy flow in two directions. Not only does higher education affect economic prosperity and the entire macroeconomic environment but that environment has a very direct impact on the operation of our institutions of higher learning. Moreover, the linkages are considerably tighter in the latter direction. Inflation, for example, can cause immediate disruptions on campus while the effects from the development of a new technology or from the revised educational standards may not be discernible for years. These macroeconomic linkages also cross national boundaries because the United States economy is inextricably tied to the world economy. Events in the global economy can have significant effects on our nation **and** on colleges and universities.

The current macroeconomic environment is dominated by major imbalances in consumption, savings, and investment. Specifically, in the 1980s the United States saved too little— consuming far more than justified by growth in national productivity. To pay for this difference we borrowed hundreds of billions from foreign investors. In a few short years the United States changed from being the world's largest creditor to being the world's largest debtor. But the world money markets generally, and our foreign creditors specifically, will not finance American profligacy into the indefinite future. The acknowledged economic wisdom is that the international financial markets accepted the constraints of election year politics. Soon our creditors will be considerably more demanding. They will expect us to clearly demonstrate that we can right our economic imbalances. We must decrease consumption and increase savings. The most obvious example of these imbalances is the federal budget deficit. The structural deficit stands at about $170 billion dollars or 3 percent of the GNP. This deficit consumes national savings and, because we must attract foreign capital to finance it, pushes interest rates higher.

The tolerance of our foreign creditors does not spring from charitable motives. Because of the composition and magnitude of international trade, the prosperity of all nations are increasingly interdependent. How effectively these imbalances are corrected is important to all our trading partners. It is in this international context that macroeconomic policies will be made. Whatever choices are ultimately selected will have tremendous impact on American higher education.

The purpose of this discussion is to sketch some plausible scenarios, identify their probable consequences for colleges and universities, and suggest what we should be doing to protect ourselves.

THE MOST LIKELY SCENARIO

The single best guess about the economic outlook is for generally favorable conditions with moderate growth and inflation — in other words, continuation of the stable expansion trajectory we have enjoyed since 1982. The Stanford inflation forecast for the next several years is in the 4 to 4.5 percent range, and the consensus of most economists is for growth of about 2.5 percent. Real interest rates are likely to remain around 4 percent with the dollar and unemployment fairly stable.

Sustaining this growth will not be an easy task and involves real sacrifice. To simultaneously maintain economic growth and satisfy our foreign creditors, the US economy must shift from one in which growth is based on domestic consumption and government spending to one based on production and exports. In turn, such a transformation requires several simultaneous policy successes. Business investment must grow to continue the manufacturing expansion that has already begun. To increase business investment, the federal budget deficit must be cut to avoid "soaking up" savings. Any significant reduction in the federal deficit will require a combination of spending cuts

and tax increases. At the same time, unless our products become intrinsically more attractive to foreign purchasers, the dollar must remain relatively weak. The sum of these changes — less federal spending, more taxes, more business investment, a weak dollar, more exports, and fewer and more expensive imports — will, by force of arithmetic, reduce the amount of GNP that is devoted to current consumption. Bergsten (1988) estimates that, barring a recession, growth in domestic consumption will have to be held to 1 to 1.5 percent per year — this compares with a growth of almost 5 percent per year in domestic demand since 1983.

The political and economic obstacles to achieving these goals are considered in the "Alternatives Scenarios" section. However, the successful implementation of these polices has direct implication for our colleges and universities. Both the flagging living standards and the need for our economy to grow out of our debt will put tremendous pressure on policy makers to increase productivity and reduce public expenditures.

Effects on Higher Education

The quest for productivity improvement will help colleges and universities by increasing the demand for research and development and for a well educated labor force, especially in the scientific and technical areas. Support for student aid will also continue but the policy rationale is likely to shift. While student financial aid has traditionally been supported on the grounds of both equity and on bringing the poor into the productive economy, the projected slow growth in living standards should noticeably shift the policy balance toward the pragmatic and economic role. Middle income families are likely to become increasing discontent with slower growth in disposable income. Their support for subsidies for the poor may wane unless these monies can be shown to have benefits that will "trickle up." We may, as a consequence, face a growing federal interest in measuring student progress and degree achievement. Furthermore, as state budgets become squeezed, all public expenditures will be reviewed with growing rigor and we should certainly expect state interest in accountability to accelerate.

In spite of the positive role that higher education has to play in improving national productivity, the urgency of the deficit reduction will limit funding for new federal programs and make it difficult even to sustain current ones. Our problem is that higher educations contribution is only seen in the long view while the politician's horizon is a considerably shorter one. With a government that seems quite willing to mortgage its future on a massive scale to sustain current consumption, our concerns about the long-run health of the academic enterprise will be very difficult to sell. Effective public relations must be major component of our efforts to sustain the financial health of colleges and universities.

The most immediate dangers for higher education stem from the urgent need to end the era of massive budget deficits and the effect of past deficits on our standard of living. The deficit pressures will directly conflict with George Bush's stated goal to be the "education president." Another concern for private institutions is the prospect of greater resistance to tuition increases from those who perceive themselves to be worse off due to lower real wages, higher taxes, or loss of federal student assistance. Pressure on prices will not be limited to instruction. Research universities' overhead rates are already under siege from federal agencies and principal investigators. This will get worse as research funding tightens. State budgets will also be affected by efforts to reduce expenditures at the federal level and this will limit funding possibilities for many public institutions, though the impact will be mitigated by the size and diversity of the individual state environments.

Perhaps the greatest danger comes in the form of efforts to "enhance" tax revenues without raising the general tax rates. Congress has already been working on stricter definitions of unrelated business income and further restrictions would limit the revenue generation capacity of both public and private institutions. Private institutions are probably more vulnerable to tax enhancement efforts because of their greater dependence on

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charitable contributions and their political independence. The deductibility of gifts was curtailed by the Tax Reform Act of 1986 and the possibilities for additional curtailment abound. The same is true for tax exempt bonds by private institutions — the $150 million cap could be lowered. More ominous, the Tax Reform Act of 1986 termed the bonds issued by private colleges and universities "private activity" bonds. At that time, however, these institutions were spared from inclusion in the state uniform volume cap — an omission which is too easily undone. If private college bonds were included in the state volume cap, access to the tax-exempt bond market would be almost eliminated for most private colleges and universities. But the most frightening prospect of all is the Treasury Department's proposal to place a 5 percent excise tax on the investment return of private college and university endowments. This would cost dearly and make it all but impossible for these institutions to sustain current programs and provide the capital needed for such established federal priorities as improved science facilities. It would also tip the precarious competitive balance between private and public institutions in the favor of the latter.

Alternative Scenarios

The scenario of continued growth conceals formidable policy tensions and some significant dangers for colleges and universities. The policy problems are economic and political and must be resolved on both our shores and abroad. A major economic challenge will be to raise our lagging productivity growth. Many economists believe that we will need to increase GNP growth to 3.5 percent if we are going to "grow our way out of the deficit." But this will be hard to achieve given that the economy is now near capacity and business investment during the 1980s was low by international and historical standards. Furthermore, to maintain growth at even the 2.5 percent level for the intermediate future we must avoid a recession. But policy makers will fight future contractions with one hand, perhaps both, tied behind their backs. The typical tools for fighting a business slowdown are monetary and fiscal. In the threat of a recession, the classic response by the Federal Reserve Board would be to increase the money supply and reduce interest rates. This will stimulate consumer demand and business expansion. However, a major reason that interest rates are as high as they are now is that we must attract sufficient capital to fund our deficit. The second policy is fiscal — deficit spending by the federal government. Again, our profligacy has boxed us in to an uncomfortable, if not untenable, corner. Prospective increases in the deficit to stimulate the economy could shake investor confidence exacerbating any downturn.

The scenario of sustained expansion may be most likely but it is highly tenuous none-the-less.

The political obstacles are no less formidable than the economic ones. To restore confidence in the dollar and rebuild our economic strength we must reduce the deficits, both budget and trade. As discussed above, the former requires higher taxation and lower government spending and the latter means that more of the goods we produce must be shipped abroad. Reduced domestic consumption is not the type of news that politicians like to bring back to the voters.

As if these difficulties were not enough, we cannot raise exports and reduce consumption without the cooperation of our major trading partners. In particular Germany and Japan, major exporters, must realign their economies for further domestic consumption. If this policy coordination is not achieved, there could be a glut of goods on the world market creating an international recession.

The scenario of sustained expansion may be most likely but it is highly tenuous none-the-less. As explained above, the fiscal and monetary tools cannot solve all policy problems at the same time. Furthermore, the hoped-for transition to a structurally balanced budget will require complex policy adjustments that are themselves error prone. The Federal Reserve will have to anticipate the tightening of fiscal policy by just the right lead time and amount and the financial markets will have to see the easing of monetary policy in the right light (and have confidence that the deficit will actually be reduced). Failure anywhere in the chain could trigger recession, inflation, or both.

Recession

Some potential causes of recession are outlined in the box on this page. What would follow a recession depends on factors like the speed of propagation of the downturn, associated defaults or bankruptcies, the efficacy of the policy responses, and the policies of our trading partners. Under one scenario, propagation is so fast that prices fall precipitously for commodities and assets like stocks and real estate before there can be any policy intervention. Interest rates plummet but since nominal rates cannot drop below zero, real rates become very high relative to the falling price level. The loss of wealth plus high real interest rates chokes off demand, causing more failures and bankruptcies — the latter made all the more likely because of high corporate debt levels. Unemployment soars, and we have a truly deep recession. It is likely that the effects are transmitted abroad due to the tight coupling of international trade and the financial markets.

The policy response to this situation is, of course, to provide large amounts of liquidity and stimulate aggregate demand by raising government spending and reducing taxes — a response that would not be long in coming. We certainly know too much to repeat the errors of 1929-33 when deepening recession triggered efforts to balance the federal budget and increase interest rates. Problems of international cooperation could hinder these policy interventions but there is little doubt that the worst consequences would be mitigated and a repeat of the Great Depression avoided even in this "catastrophic case."

Inflation

The more likely result of a policy response to a threatened economic downturn is that the Federal Reserve will act at the first sign of trouble, thus preventing a severe downward spiral. This is, in fact, what happened in the days following October 19, 1987. The biggest danger in that response would be to overshoot the mark, thus triggering a round of inflation some months later. Widespread defaults, bank failures, bankruptcies, and high unem-

Widespread defaults, bank failures, bankruptcies, and high unemployment are simply not tolerable in economic or political terms. The Fed would have little choice but to run the risk of erring on the side of easy money.

Recession Scenarios

Recession could be triggered by any of the following:

(1) **The Business Cycle.** The expansion is seven years old and the economy is at capacity; faster expansion requires higher interest rates to constrain investment demand, leading to a classic downturn.

(2) **Budget Balancing.** In an effort to restore market confidence, the federal government takes serious steps to reduce the federal budget deficit but these measures are too severe and a recession follows.

(3) **Protectionism.** Reducing the federal deficit and trade deficit simultaneously requires that our trading partners export less and import more. For a variety of reasons particular to their political environments, they may not accede to this change. If trade barriers grow and world trade slows a world-wide recession could follow.

(4) **Flight from the Dollar.** Foreigner creditors lose confidence that the United States will get its economic house in order and they withdraw from the U.S. debt markets. The Fed raises interest rates to protect the dollar (a diving dollar only exacerbates the situation) causing consumption and business investment to fall.

(5) **Defaults.** There are at least three groups of potential debt problems — thrift institutions, corporations newly capitalized with "junk bonds," and "lesser developed countries" (LDCs). If defaults by any one of these sets of debtors should get out of control, the loss of wealth and financial confidence could undermine the financial markets, reducing investment and consumer confidence and, as a consequence, aggregate demand.

In assuming the likilhood of inflation we should not forget its advantages-- most significantly, inflation transfers real wealth from lenders to borrowers — and the United States has become the largest net borrower in the world.

ployment are simply not tolerable in economic or political terms. The Fed would have little choice but to run the risk of erring on the side of easy money. Any loss of confidence on the part of foreign lenders would drive the dollar sharply downward because of increasing interest rates would not be an option. In the longer run we would have to rely on the lower dollar to aid our trade balance and permit the fire-sale of U.S. assets at bargain prices. But the weak dollar may not bring much relief if other countries erect trade barriers to protect their own industries.

The causes of inflation summarized in the box below are certainly not unlikely. Few people want inflation but in assessing its likelihood we should not forget that it has advantages despite the fact that any move in an inflationary direction will surely produce a swift negative reaction in the financial markets. Consider these points: (1) Inflation transfers real wealth from lenders to borrowers — and the United States has become the largest net borrower in the world. (2) Inflation moves people up in the tax brackets and, to the extent that brackets are not completly indexed, this adds to public revenues; (3) Inflation generates "capital gains" and increases the spread between historical and replacement cost depreciation. (4) Inflation creates opportunities for reducing real wages without the trauma of lowering nominal wages.

If We Fall, Which Way?

The United States faces enormous challenges in the form of flagging productivity growth, a seemingly intractable federal budget deficit, stagnant domestic investment, an apparent addiction to foreign debt with its service requirements, and an unfavorable balance of trade. Politicians and policy makers must answer to a restive electorate but past excesses have given foreign creditors a good deal of control over our destiny. The economic policy problems facing the United States have been described as an extraordinarily dangerous "tight-wire act." The slightest overcorrection in one direction or the other could bring disaster. In response to a downturn will we act too late with too little and bring about a severe recession? Or, will the policy hand be too heavy and unleash inflationary forces?

Sadly, the "tight-wire" metaphor is too comforting. It implies that the fall will be in one direction or the other. We could be visited by recession and inflation simultaneously and college and university financial managers should be on guard against various combinations of recession and inflation. However, our best guess is that inflation represents the greater long-run threat. Recession is certainly possible at any time. Indeed, it may be more likely than inflation in the short-run. But recessionary threats are likely to be dealt with

Inflation Scenarios

Inflation could be caused by any of the following:

(1) **Policy Error.** The Fed errs on the side of liquidity and low interest rates. This might occur as part of its normal operations or, more likely, it could result from a too aggressive corrective action to a sharp downturn.

(2) **Flight from the Dollar.** Foreign investors withdraw from the U.S. debt market, driving the dollar down in spite of attempted policy interventions. The higher import prices trigger a round of inflation.

(3) **Commodity Price Shock.** External events cause the price of an important commodity to rise precipitously, setting of a series of price increases. Obviously oil, powered by the OPEC cartel or perhaps a middle eastern conflict, is the most obvious candidate.

(4) **Political Relief from Debt and Budget Problems.** Politicians, responding to a public chafing under heavy debt and related tax burdens, ineluctably accede to inflationary policies as explained in the text.

swiftly, quite possibly at the risk of triggering inflation. When all is said and done, inflation's causes are more popular with more people than is the preventive medicine, however unpleasant the prospective discipline of the financial markets may be.

Our policy makers will try sincerely to avoid inflation, but if it comes to a choice between inflation and recession, inflation will win. We do not believe that the strong anti-inflation policies of the Volker years are likely to be repeated under today's conditions. The size of our foreign debt but, more importantly, the perils posed by our excessively leveraged corporations, the struggling LDCs, and the fragility of many thrift institutions make that medicine too dangerous. In all probability, we shall have to experience a period of renewed inflation — perhaps even double-digit inflation and some of the debt relief that would bring — before we would be willing to accept recession in return for price stability.

(Our arguments notwithstanding, Dalton and Greiner argue that the financial markets will not tolerate inflationary policies. They assert that a major upward shift in inflation is unlikely. Readers of the Jossey Bass volume can independently assess their case.)

Implications for Colleges and Universities

These economic winds will be felt throughout our institutions of higher education. They will affect curriculum, personnel and enrollment policies as well as financial management. This discussion and the other chapters in the Jossey-Bass volume, *Financial Planning Under Economic Uncertainty*, focus primarily on financial matters. Volume 3, Number 1 of *Capital Ideas* considered some of the programmatic implications.

What can college and university financial officers do to blunt the negative effects of deficit reduction and the prospect that we will experience inflation, recession, or both? There **are** strategies that can make a difference. Indeed, strategic thinking has never been more important than at present as all institutions are vulnerable. Public institutions, with heavy dependence on state spending, must be prepared to live with the vicissitudes of that support. Recent reports suggest that the squeeze on state budgets has already begun. While private college support will be more stable, it will not be any more abundant. Incomes may not keep pace with college costs and the downward spiral in savings rates will erode family financial reserves. Equally important, labor force participation by women has risen dramatically in the last few decades. In the coming years fewer families will have a reserve worker waiting to enter the labor market to help support the family during the years of higher college tuition payments. The private research university which has always seemed unshakable, may be particularly vulnerable with its heavy dependence on federal research support, tuition, and investment income.

The strategies considered here fall into four broad categories related to (1) current operations, (2) capital for facilities and equipment, (3) investments, and (4) public image. The model constructed by Professor Nordhaus (included in the Jossey-Bass volume) shows that the greatest effects of economic events on private research universities are in the area of program support and investment return. The effects of price changes on operating costs tend to be balanced by corresponding changes in operating revenues, other things being equal. The following strategies are consistent with that view.

Strategies Related to Current Operations

1. **Avoid optimistic income forecasts**, particularly income to be derived from the federal government (such as indirect cost recovery), investment earnings, and gifts. Be alert to the possibility of increased price resistance from tuition payers and the Federal research sponsors.
2. **Avoid heavy forward commitments**, especially those that depend on anticipated income growth. Be prepared to retrench quickly if income growth turns down or the actual level of income declines.
3. **Establish cost containment programs** to reduce the need for future

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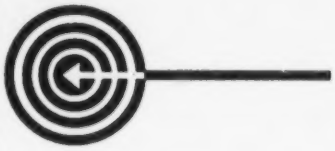

Projected growth in research volume and related revenue and expenditures associated with new facilities must be fully integrated into future plans.

In spite of the current investment risks the endowment must be managed with a long-term perspective in mind.

tuition and overhead rate increases. These should include processes for enhancing productivity in both academic and administrative areas and harvesting the results as cost savings, i.e. as opposed to quality improvements.

4. **Maintain or create budget flexibility** to respond to initiatives that a sluggish economy will force on higher education. Funds may be needed to build more elaborate cooperative ventures with industry, specifically to assist in the transfer of technology to the manufacturing sector. Improving elementary and secondary education is also likely to become a higher priority issue.

Strategies Related to Capital for Facilities and Equipment

1. **Develop detailed plans for sources and uses of capital**, and stick to them. The need for expenditures on facilities and equipment is very great but sources of capital cannot be taken for granted because of the pressures on state budgets, increasing competition for philanthropy, and the high cost of debt. While long-term debt is advantageous during a period of sustained inflation, debt service could be difficult in an environment characterized by income instability. Moreover, current high real interest rates presumably fully discount prospective inflation.
2. **Minimize institution-wide capital costs and, for public institutions, the state's overall cost of capital.** Avoid using cash for a capital project which qualifies for tax-exempt financing while using taxable debt for another project.
3. **Fully integrate capital budgeting with financial forecasting of operations**. In addition to making appropriate provision for the transfer of unrestricted funds as needed by the capital budget, projected debt service and operations, maintenance, and utilities for new buildings must be included in the operating forecasts. Similarly, projected growth in research volume and related revenue and expenditures associated with the new facilities must be fully integrated into future plans. Failure to forecast these costs and revenues accurately is serious anytime but especially so in times of financial stringency. The integration of operating and capital budgets can result in decisions to defer building projects that might be affordable solely on the basis of capital considerations.
4. **Use hedging techniques** as appropriate to minimize risks. The Gurwitz chapter in the Jossey-Bass volume considers these methods in some detail.

Strategies Related to Investments

1. **Minimize long-term fixed income investments**. It is important to maintain a sufficient position in high-quality long bonds to put a floor under endowment yield during a sharp recession. However, the potential for transferring wealth from lenders to borrowers during a period of unexpected and sustained inflation makes this a dangerous time for bond-holders.
2. **Sufficient working capital** in "money market" funds is desirable for several reasons. It provides "yield insurance" as discussed above and raises current return as compared to many equity assets. It also protects against the down-side risks of both inflation and recession while providing a source of funds to take advantage of special investment opportunities created by volatile markets.
3. **Continue to invest in equities and real estate** to obtain a solid return coupled with inflation protection. In spite of the current investment risks the endowment must be managed with a long-term perspective in mind. Shopping centers with percentage rents and office buildings with inflation-protected leases are particularly attractive in this regard. The latter can also be a useful hedge against recession, provided the leases are long and with low-leveraged blue-chip clients.
4. **Avoid highly leveraged investments** such as certain real estate

deals and leveraged buy-outs. These will be particularly vulnerable during a recession and must be avoided.

5. **Diversify Internationally** to hedge uncertainty with respect to the dollar and the domestic economy. Such diversification will be particularly important if the U.S. fails to deal adequately with the deficit.

A relatively new technique for portfolio construction, strategic asset allocation, is described the in the Dalton and Greiner chapter. They explain how institutions can more specifically balance their portfolios in a changing economic environment.

Strategies Related to Public Image

As mentioned earlier, colleges and universities are extremely vulnerable to adverse policy decisions at the federal or state level. We expect fair treatment, or even special consideration, because we are engaged in "public service." However, too frequently higher education is perceived to be just another self-interest group and acting that way. All of our policies, including financial ones, can have adverse consequences in this unstable financial environment. We must be extremely cautious that, in efforts to strengthen our institutions' financial base, we not offend public and legislative sensibilities. Because of this political vulnerability, we offer the following additional recommendations:

1. **Use Caution in Generating Unrelated Business Income**. The small business community has become increasingly concerned about unfair competition from non-profits and specifically from colleges and universities. Even paying associated taxes will not quell the criticism if we take unfair advantage of our captive markets and/or fail to show appropriate sensitivity to small businesses that rely on our students and staff as customers.
2. **Do not Abuse Tax-Exempt Status**. Dimensions of this issue range from relations with local governments to the sale of tax advantages. Our increasing relations with the corporate world will undoubtedly open up new possibilities for gain which, while not being illegal, may be offensive.
3. **Use Tax-Exempt Debt Prudently**. Most of the obvious abuses have been shut off by the Tax Reform Act of 1986. However, no legislation is 100 percent effective and we are probably more vulnerable to perceived abuse here than anywhere else. The institutional volume cap could be extended to public institutions or private institutions could be included under the state uniform volume caps.
4. **Avoid Overly Aggressive Investment Policies**. There has already been criticism about university endowment participation in leveraged buy-outs and it could grow. Even heavy overseas investments could be attacked as un-American.

None of these strategies call for budget reductions, but rather are aimed at the more effective management of program growth, the diversification of investments, and the avoidance of highly optimistic or leveraged positions in either area. Finally they take into account a political environment that is likely to be dominated by economic issues — one in which politicians will need little excuse to decrease expenditures or to increase short-run public revenues.

The adoption of these strategies will not guarantee that institutions will emerge unscathed from whatever may happen in the larger economy. But they should help.

Higher education officials must be extremely cautious that, in efforts to strengthen their institutions' financial bases, they not offend public and legislative sensibilities.

Summary

The macroeconomic environment is likely to be extremely volatile for the coming decade. This is an important time for colleges and universities and states to conserve capital for use on facilities and equipment and to provide investment return for future operating subsidies. It is certainly no time for policies that dissipate significant amounts of capital through current operating deficits, however strong the immediate program claims. Nor is it a time for investments that do not take into account the possibility of a sharp recession and, particularly, a sustained inflation. This is a watershed time when the future of many institutions could be profoundly affected by current financial policy decisions.

Correcting the economic imbalances of the past decade will dominate public decisions well into the 1990s. America's colleges and universities will be called on to assist in raising US productivity and to tighten our belts and use resources as prudently as possible. But prudence is likely to be defined differently by college administrators, by public officials, and by families. We must be alert to these discrepancies and make our case for continued public and private support as forcefully and as clearly as we can.

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